Internal Control, Total Quality Management and Audit Committees: Implementation of Good Corporate Governance

Review of Integrative Business & Economics Research

Tresno Eka Jaya
Faculty of Economics, Universitas Negeri Jakarta

Muslim
Faculty of Economics, Universitas Negeri Jakarta

Nuramaliah
Faculty of Economics, Universitas Negeri Jakarta

ABSTRACT

This research aims to analyze the influence of internal control, total quality management (TQM), and audit committeeson the implementation of good corporate governance. Good corporate governance,the dependent variable,wasmeasured by institutional ownership. Independent variables related to internal control were measured in terms of financing, those pertaining to TQM were measured by market shares and those describing audit committees were measured by the number of audit committee meetings in one year. This research uses data presented in the annual reports of Indonesia Stock Exchange Listed Manufacturing Companies in the period 2011 to 2013. The evidence shows that internal control and TQM have no influence on the implementation of good corporate governane, but audit committees do.

Keywords: Internal Control, Management, Audit Committee .

INTRODUCTION

Indonesia is a market-based economy, where the government has the most important role. The economic system in Indonesia is one based on a set of interdependent rules, aspects and mechanisms. The allocation of resources is owned by the State and the government tries to ensure fair and equitable allocation to the entire community. However, because of various problems including the economic crisis in Indonesia,the objectives have still remained unrealized. This is due to the emergence of elements related to corruption, collusion, nepotism, difficulties in maintaining rule of law, monopolies dominating economic activity of public servants of low quality (Edy, et al., 2014).

There is a broad agreement that good corporate governance is totally a responsibility of the company. The economic crises of Asia and Latin America arose because of the failure to ensure good corporate governance (GCG) (Daniri, 2005). Fraud cutting across from the business to the international world has underscored the need to

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

contain fraud at the company level. According to the Forum for Corporate Governance in Indonesia (fcgi, 2001;Ferlencia and Ronny, 2014), the principles GCG include fairness, disclosure and transparency, accountability, responsibility, and independency.

Another indicator of weak implementation of good corporate governance is high incidence of corruption cases. Problems leading to delayed economic growth also lead to more unemployment and poverty.The development of TQM also gets delayed. Dysfunctional organizational culture and weak cooperation at the functional levels are two major barriers(Hiras, 2009). Case studies sugget that poor company performance arises mainly from poor corporate governance.

An effective internal control system can prevent large losses.Without it, obstacles and risks causing large losses can remain undetected by the owners of the company for too long without being detected (Jeffery, et al., 2014).One approach particularly in the era of globalization is to apply the concept of Total Quality Management in manufacturing and service industries as well as strategies to prepare themselves by developing the quality of employees and managers with the aim of increasing the quality and productivity of production processes in an optimal and sustainable manner (Nastiti, 2013). Further, in view of increasingly fierce global and regional competition,TQM should be followed up by the application of management accounting systems, e.g.,performance measurement and reward systems.These are important control tools that can be used by companies to motivate employees to achieve corporate objectives in accordance with the behavior expected from the company. Poor GCG is closely related with the company's internal control systems. Internal controls can also explain the application of the principles of good corporate governance (Pratolo, 207: 3, in Tiara, 2014). Good governance should provide effective protection for shareholders and creditors, so that they are assured of returns commensurate with investment. A good corporate governance system helps create a conducive environment for the growth of the efficiency of the corporate sector (Gusnardi, 208: 35) in (Tiara, 2014). This study assesses the impacts of internal control and TQM on the application of good corporate governance at the company. To this end, the authors conducted a study titled "The Effect of Internal Control and Total Quality Management to the implementation of Good Corporate Governance (Study on Manufacturing Companies Listed in Indonesia Stock Exchange 2011-2013)".

THEORITICAL BACKGROUND

Agency Theory

Agency theory is a foundational feature of corporate governance, in particular about the existence of the committee which is expected to mitigate the conflict between the agent and the principal. The theory proposes a series of mechanisms to bring together the interests of shareholders and managers such as thosefor internal oversight by the board of directors and audit committee oversight on behalf of majority shareholders, the internal control and external supervision carried out by external auditors to preparethe financial statements of the company (Fama and Jensen, 1983;Meizaroh and Lucyanda, 2011).

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

Good Corporate Governance

According Sedarmayanti (2012: 23in Tiara, 2014),"Good corporate governance is a system, process, and a set of rules that govern the relationship ofthe various interested parties, especially in the narrow sense, the relationship between shareholders, board of commissioners and board of directors for the achievement of organizational goals".

According to Ministerial Decree No. KEP-117/117 / MMBU / 2002 on the Implementation of Good Corporate Governance in (Tiara, 2014), the principles of good corporate governance are: Transparency (Disclosure),Independency, Accountability, Responsibility (accountability), Fairness (Equality and Fairness)According Murhadi (2009), a company needs a mechanism or method to be applied in the company, including the existence of institutional ownership.

Institutional Ownership

Institutional stock ownership refers to shares owned by institutional investors. Institutional investors include banks, pension funds, insurance companies, institutions collecting funds, and other financial institutions (Nur, 2013). The ownership structure reflected in the mechanisms of good corporate governance is the institutional ownership, which is defined as shareholding by a particular institution or agency (Tarjo, 2008;Putu and Wayan, 2014).

According to Nasution (2013), the audit committee is a committee established by the board of directors to carry out the task of monitoring the company's management. The existence of an audit committee is very important for the management. The audit committee is a new component in the control system of the company. According Chrisdianto (2013), in order to carry out its duties, the audit committee should conduct a formal communication by way of a meeting between the board, management, external auditors and internal auditors.

H1: The Audit Committee has influence on the implementation of good corporate governance.

Internal control

According to Theodore (2013: 352,Tiara, 2014) "Internal control is a process, policies, and procedures designed by management to ensure reliable financial reporting and financial reporting in accordance with the applicable accounting framework".

According to the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in (Mega, 2012), there are five components of internal control:environmental control, risk assessment, activity control, information and communication, andmonitoring.

H2: Internal control has impact on the implementation of good corporate governance.

Financial performance

According to Rizky (2013),company performance is a picture of the financial condition of thecompany andis analyzed with the tools of financial analysis, so that one can find out about the merits or otherwise of thecompany's financial situation over a particular period. It is very important that resources are used optimally in the face of

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

environmental change. According to Silvi and Siti (2013),the elements of the company's financial performanceinclude profitability ratios, financial leverage, liquidity ratio, and certain ratio smeasuring activity.

Financial Leverage

Solvency ratio (financial leverage) measures the extent to which the company's assets are financed by means of debt. A company is said to be solvent if it has assets sufficient to pay off all its debts; otherwise it is in a state of insolvency(Danang, 2013: 111). Measuresfor solvency ratio (Financial Leverage) proposed by Silvi and Siti (2013) include the ratio of debt to total assets, the ratio of debt to equity, the ratiolong-term debt to equity, and the number of times interest was earned.

Total Quality Management

Total Quality Management (TQM) can be defined as a management system oriented towards customer satisfaction;activities are pursued once they are correct (right first time) through continuous improvement and improvement of employees. The goal is to be ‘right first time’. Total Quality Management (TQM) is a management system that elevates quality as a strategy towards achieving competitive advantage which oriented to customer satisfaction by involving all members of the organization (Khalil Amin, 2013: 12).

Customer Perspective

From the perspective of the customer, Kaplan and Norton (2001) in (Jeffery, et al., 2014). explained that there are two groups of related measurement. Costumer core measurement, or the so called core measurement has several measurement components:the market share (the part of the existing market controlled by the company on the whole), the volume of unit sales, andthe number of customers these measurements reflect.

Customer retention, is used to measure the rate at which the company can maintain relationships with customers.Customer acquisition is the rate at which a business unit is able to attract new customers or win new business.Customer satisfaction assesses the level associated with specific performance criteria in a value proposition.Customer profitability measuresthe net income from each customer or segment after subtractingcosts required to support the specific customer.

Customer value proposition is made up ofcore values based on product or service attributes, which concern the functioning of a product or service, price and quality. Depending on the product being offered, customers have different preferences. There is a priority function for each product, quality or low price. The company must also be able to identify what customerswant with regard tothe products or services offered. The next set of performance measurements are determined accordingly.

Customer relationship is associated with the feelings of customers towards the products offered by the company. Consumer sentiment is influenced by the responsiveness and commitment of the company to customers in relation to the problems concerning timely delivery; time is an important component in corporate competition. Consumers

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

generally assume that rapid order completion and timelinessare importantfactors affecting their satisfaction.Image and reputation, are some intangible factors that can attract consumers to readilyand directly contact the company. Building image and reputation can be done through advertising while keeping quality as promised.

Market is the target for success in achieving the marketing objectives; a company needs to know its position in the market.The company's position in the marketcan be seen from the market share held by the company, i.e.,by the size of a part or the total extent of the market that is being controlled by a single company, which is usually expressed as percentage.

Good corporate governance has synergies with TQM; the company's management style can accord with the concept of quality management which includes being strengthened by the principles of good corporate governance.

H3: Total Quality Management has influence on the implementation of good corporate governance

OBJECTIVES AND RESEARCH METHODOLOGY

The population in this study are all manufacturing companies that have published financial statements l in the Indonesia Stock Exchange in the period 2011-2013 and issued data on product sales.

The samples in this study were chosen on the basis of the purposive sampling method sampling technique (Rudi, 2013). The selection of a group of subjects in purposive sampling is based on certain characteristics that are known to have a close relation with the characteristics of the population (Rudi, 2013). In other words thesample unit is adapted in light of certain criteria based on objective research so as to achieve the purpose of obtaining an appropriate sample.

The criteria used to select our sample were as follows:
The manufacturing company's financial statements issued during 2011-2013;
Manufacturing company that publishes the amount of product sales;
The website of each company; and details of manufacturing.
All the available detailed data (data are published as a whole during the period from 2011 to 2013) associated with variables used were analyzed.

Variable Definitions and Measurements

Good Corporate Governance

The dependent variables used in this research mainly pertained to the implementation of good corporate governance, defined a system, processor set of rules that govern the relationships of the various stakeholders inachieving organizational goals (Bieber, 2014). The ownership structure influencing good corporate governance is the institutional ownership (Tarjo, 2008;Putu and Wayan, 2014). According to Nur (2013), institutional stock ownership is ownership of shares owned by institutional investors. Institutional investors include banks, pension funds, insurance companies, institutions

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

collecting funds, and other financial institutions. Good corporate governance is measured by comparing the number of shares owned by institutional investors with the total number of shares outstanding (Nur, 2013).

Internal Control

Internal control is a process influenced by the board of directors, management and other personnel in the company. It is a processdesigned to provide reasonable assurance with respect to the achievement of corporate objectives (Ferlencia and Ronny, 2014). Internal control measures the risk facingthe company using a financial leverage (Silvi and Siti 2013). The *Solvabilitasratio*(Financial Leverage) is a ratio that measures the extent to which the company's assets are financed by debt, a company is said to be solvent if the company has an asset or sufficient assets to pay off all his debts (Danang, 2013: 111). Financial Leverage is measured by the ratio of total debt to total assets Ratio:
TDtTAR = (Total Debt) / (Total Asset) ×100%,
according to (Galuh, 2013).

Total Quality Managementtre (Management)

Total Quality Management (TQM) is a management system oriented towards pursuing customer satisfaction activities in a'right first time' manner through continuous improvement and the improvement of employees (Amin and Khalil, 2013: 12) and measuring success in the field of marketing; a company needs to know its position in the market(Assauri, 2014: 101). Position in the marketcan be seen from the market share held by the company. Market Share is the size of a part or the total breadth of the market controlled by a single company;usually expressed in percentage (Assauri, 2014: 101). The market share is calculated asthe ratio between the company's annual sales in units and total annual sales of all similar companies or industries multiplied by 100(Assauri, 2014: 101).

The Audit Committee

The variable 'Audit committee' is measured by using the frequency of meetings of the audit committee as reported in its annual report(Nur, 2013) and (Dwi, et al , 2011).

Data Collection

A sampling method was used while collecting data. Data were also collected through secondary data from the manufacturing company's financial statements and data on the number of sales of products of the company.

Data analysis technique

The analytical method used is the method consiting of several steps: test descriptive statistics, classic assumption test (consisting of tests for normality, multicoloniarity, autocorrelation, heteroskidastity), and hypothesis testing composed of statistical t-tests, simultaneous significance test (F tests), and coefficient of determination (R^2).

DISCUSSION

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

Based on the regression model testing with redundant fixed effect, it couldbe concluded that random effects modeling (REM) was appropriate. The results from multiple linear regression analysess were as follows:

Table 1 t-test

Model	Unstandardized Coefficients		Standardized Coefficients	*t*	Sig.
	B	Std. Error	Beta		
(Constant)	.289	.053		5.415	.000
PI	-.106	.054	-.203	-1.950	.055*
TQM	.212	.108	.205	1.958	.054*
KA	.008	.003	.233	2.219	.029**

Dependent Variable: GCG
Predictors: (Constant), KA, PI, TQM
Notes: GCG= *Good Corporate Governance* **,** PI= Internal control
TQM= *Total Quality Management ,* KA= Audit commite*,* **e**= *Error*
* Significance at 10 %
** Significance at 5 %
*** Significance at 1 %

Analyses of data using multiple linear regression could explain the factors that affect good corporate governance. Prior to the analysis, the t-tests statistic and simultaneous significance tests (F tests) were conducted. Regarding the effect of internal control on good corporate governance, the t-statistic for internal control was equal to -1.950 which shows a value smaller than that in the t-table (1.990) with a significance level of 0.055 which is above the norm of 0.05. It can therefore be concluded that H1 is rejected, i.e., internal control has no effect on good corporate governance.

Effect Total Quality Management onthe Implementation of Good Governance

Total Quality Management hada t-value of 1.958 which issmaller than t table that is equal to 1.990 with a significance level of 0.054 which is above the 0.05 significance level. It can be concluded that H2 is also rejected:Total Quality Management has no effect on Good Corporate Governance.

The Audit Committee effect on implementation of Good Governance

The Audit Committee is expected to influence good corporate governance. Audit Committee had a t-value of 2.219 which is greater than that in the t-table (1.990)at a significance level of 0.029 which, in turn, is under the significance level of 0.05.

Conclusion: audit committees do impact good corporate governance.

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

Effect of Internal Control onthe Implementation of Good Governance

Internal control, total quality management, and audit committee affect the implementation of good corporate governance; an F test yielded an F value of 3.953 which is greater than that in the F table with significance df 1= 3 and df 2 = 80 is equal to 2.719 reinforced with a significance level of 0.011 which is smaller than the significance level of 0.05. So we can conclude that X1: internal control, X2: Total Quality Management and X3: Audit Committee individually or together have significant effect(s) on Y: Good Corporate Goverance.

CONCLUSIONS AND RECOMENDATIONS

Conclusion

Represented by debt to asset ratios, Internal controlshave t-statistics smaller than those stipulated in the t-table which is above the significance level of 0.05, i.e.,Ha is rejected. Thisshows internal control has little effect on good corporate governance.

Total Quality Management, represented by market share has a t-statistic smaller than that stipulated in the t-table at a sigificance value above 0.05,i.e., that Ha is rejected. Thisshows thatTotal Quality Management has no effect on good corporate governance.

The variable, Audit Committee, as assessed by the frequency of audit committee meetings (number of meetings of the audit committee), has a t-statistic larger than that stipulated in the t-table; i.e., H0 has received support. This shows that Audit Committee does impact good corporate governance.

Recommendations for future research

Future studies should be able to develop other variables that can affect the good corporate governance; the present analysis yielded a coefficient of determination equaling 9.6%, which means there are many other factors besides the variables in this study that might be affecting good corporate governance, e.g., Debt to Equity Ratio, Long-term debt to equity ratio, times interest earned.

REFERENCES

[1] Anggarini, Novita and Cescilia Srimindarti. 2009. "Effect of Shareholding Institutional and Policy of Debt to Managerial Ownership" *Accounting Journal*, ISSN: 1979: 4886, Vol. 1 No. 2.

[2] Ardiati and Yanti.2013. "The effect of the Audit Committee, the Return On Assets and Debt to Total Assets of the Audit Report Lag".Yogyakarta.

[3] Arifiani and Rizky.2013. "Effects of Good Corporate Governance for Financial Performance". *Journal Akuntansi*.Malang.

[4] Assauri and Sofjan.2014. Marketing Management (Basic Concepts and Strategies). *Prints 13th January 2014. Jakarta: King Grafindo Persada*.

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

[5] Avianaand Putu Mega Selvya.2012. "Implementation of Internal Control in Computer-Based Accounting Information Systems".*Scientific Journal Accounting*, Vol 1, No. 4.

[6] Azizah, Nurlaili.2013. "Using the Scientific Method in Research".Surabaya. *http://nurlaili-azizah-fisip11.web.unair.ac.id/ (Accessed February 21, 2015)*

[7] Chrisdianto, Bernadinus.2013. "The role of the Audit Committee in the Good Corporate Governance" *Actual Journal of Accounting*, Vol. 2, No. 1.

[8] Djajendra.2010. "6 Steps Implementing Good Corporate Governance".Corporate Motivator.

[9] Dwi, Wulan Utami, dkk.2011. "Mandatory Disclosure Compliance Levels and Relation with Good Corporate Governance Mechanisms" .*Jurnal Accounting.*

[10] Ghozali, Imam. 2011. Applications Multivariate Analysis with SPSS. Semarang.

[11] Hajat, Nurahma. 2012. "Guidelines for Undergraduate Thesis Writing". Jakarta: Faculty of Economics, University of Jakarta.

[12] Hanifah.2011. "Effect of Ownership Structure, Organizational Culture, the Audit Committee and Internal Audit to good corporate governance and its implications on the financial performance of SOEs", *Jurnal Akuntansi ISSN 2089-3590* .Bandung

[13] Hariyati, Maryuni and Ongki Dessy Rini Oliviani.2013. "Influence Management Audit and Internal Control of the Company's performance with good corporate governance as an intervening variable", *the ISBN 978-979-636-147-2. East Java.*

[14] Iriani, Yani and Arief Rahmana.2013. "Analysis of Implementation of Total Quality Management (TQM) to the quality of their Employee Performance through Innovation" .Bandung

[15] Junita, Silvi and Siti Kharina.2013. "Analysis of Company Performance by Using Ratio Analysis Financial Telecommunication Company Listed in Indonesia Stock Exchange" *Accounting .Jurnal*.

[16] Lestari, Tiara Ayu.2014. "Influence Effectiveness of Internal Control of the Application of the Principles of Good Corporate Governance and Financial Performance Implications" .Bandung

[17] Meizaroh and Lucyanda.2011. "The Effect of Corporate Governance and Ownership Concentration in the Disclosure Entreprise Risk Management", *the National Accounting XIV symposium Aceh.*

[18] Mintje, Nastiti.2013. "The influence of Total Quality Management, Systems Award, and Performance Measurement System for Managerial Performance", *in the Journal from 2303 to 1774 Vol.1 ISSN # 3 Page. 52-62.*

[19] Morita, Lestari Indah.2013. "The Influence of Organizational Culture and Internal Control of the Application of the Principles of Good Corporate Governance" .Padang.

[20] Murhadi, Warner.2009. "Effects of Good Corporate Governance on Earnings Management Practices at the Company listed on the Indonesia Stock Exchange" *Accounting Journal*.

[21] Nasution, Marihot.2013. "The role of the Audit Committee in the Banking Company Earnings Management"*Jurnal Akuntansi.Batam*

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)

[22] Nauli, Marcelinus SANGAP, et al., 2014. "The Effect of Internal Control and Audit Committee on the Implementation of Good Corporate Governance Levels", *in ISSN =; 2337 to 3067 Journal of Economics and Business, Bali*.
[23] Nur Fitri, Galuh.2013. "Effects of Good Corporate Governance for Corporate Social Responsibility Disclosure on Company registered in BEI.Jakarta".
[24] Pasaribu, Hiras. 2010. "Effect of Commitment, Perception and Application of Basic Pillars of Total Quality Management for Managerial Performance (*Survey on Manufacturing SOE in Indonesia*)".
[25] Pertiwi, Nina.2012. "The relationship between the performance of the Audit Committee with the Earnings Quality" *Scientific .Jurnal Vol. 1 No. 1.Surabaya*
[26] Priscilla, Mary Bernadette and Eka Novianti.2012. "The role of the Internal Control System on Inventory Management for Good Corporate Governance", South Jakarta.
[27] Putu, Ni Wayan and Wayan I Suartama.2014. "Effect of Managerial Ownership and Institutional Ownership on Corporate Value" *Journal Akuntansi.ISSN: 2302-8556.Bali*
[28] Saptapradipta, Patricia.2014. "Effect of Internal Audit and Internal Control of the Implementation of Good Corporate Governance" .Malang.
[29] Sujana, Edy., Dkk.2014. "Influence of the Internal Control System, Financial Management and Organizational Commitment on the Implementation of Good Governance" *Accounting .Journal S1 (Volume 2 No. 1 2014) .Singaraja*
[30] Sumadyo, Dimas.2013. "The influence of Independence of Internal Audit and Audit Committee for Good Corporate Governance".
[31] Sunyoto, Danang.2013.Dasar-base Perusahaan.Cetakan First Financial Management, 2013.Yogyakarta: CAPS (Center of Academic Publishing Service).
[32] Susilana, Rudi.2013. "Module Population Sample " .Bandung http://file.upi.edu.ac.id/
[33] Syukron, Amin and Muhammad Khalil. 2013. Six Sigma (Quality for the Business Improvement) *first .edition, 2013. Yogyakarta: Graha Science*.
[34] Widjaja, Ferlencia and Ronny H. Mustamu.2014. "Influence of the Internal Control System Implementation of Principles of Good Corporate Governance in the company Ceramic Industry", *Journal Accounting and Finance Vol. 2, No. 1.Surabaya.*
[35] Wijaya, Jeffery, et al., 2014. "The Effect of Internal Control Implementation, Organizational Culture and Total Quality Management to the Implementation of Good Corporate Governance". *Journal Of Accounting Singaraja, Indonesia*.
[36] Zulkarnain, Joni.2014.Total Quality Management.Jakarta, *https://jonizulkarnain.wordpress.com (Accessed February 14 2015)*

ISSN: 2304-1013 (Online); 2304-1269 (CDROM); 2414-6722 (Print)